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In the

Supreme Court of the United States

OCTOBER TERM, 1969

No. 1459

EUGENE P. RUEHLMANN, EXECUTOR OF THE ESTATE OF FRANCES FOSTER WELLS, DECEASED,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF AMICUS CURIAE ON BEHALF OF GEORGE R. BRADLEY, EXECUTOR UNDER WILL OF M. WINIFRED ANDERSON, IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

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Interest of Amicus Curiae

This brief *amicus curiae* is filed with the written consent of the Solicitor General and of the petitioner's counsel. It is filed on behalf of the taxpayer in a case at issue, but not yet tried, pending in the United States District Court, Western District of New York (Civil No. 11,873), seeking refund of estate taxes on the identical legal and constitutional grounds which form the basis for the petition herein. The decedent in the New York case died on February 10, 1964, only two weeks after the death of the Ohio decedent in the case at bar.

ARGUMENT

A Writ Should be Granted to Resolve this Widely-debated Issue of Constitutional and Public Importance.

The wide importance of the issue, described in the petition, to thousands of executors and legatees appears self-evident. Nearly every estate of any size today contains some "mutuals". Indeed, in the aforesaid New York case, virtually the entire estate consists of such securities. We earnestly submit that a writ should be granted because of the importance of the issue, irrespective of any present conflict in lower courts.

The estate tax is not an inheritance tax or a property tax, but is a transfer tax. It is imposed upon the *transfer* of property of a decedent, not upon its *receipt* by a legatee; upon its market value, not upon its replacement value.

Section 2031 (a) of the Internal Revenue Code provides that the value of a decedent's intangible personal property shall be determined by its *value* at the time of death. The term "value" has been defined in Section 20.2031-1 (b) of the Estate Tax Regulations as the "fair market value" of the property, which is again defined generally as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts". The fundamental purpose of the Code, reflected in the quoted section of the Regulations, is to value intangible personal property of a decedent at the price which it would bring if sold and liquidated in a fair market on the date of death.

The position of the petitioner is in accord with the definition of an open-end investment company set forth in the Investment Company Act of 1940. Section 5 (a) of that

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Act defines such a company as one "which is offering for sale or has outstanding any redeemable security of which it is the issuer." The term "redeemable security" is defined in Section 2 (a)(31) of that Act to mean "any security, other than short-term paper, under the terms of which the holder, upon its presentation to the issuer or to a person designated by the issuer, is entitled (whether absolutely or only out of surplus) to receive approximately his proportionate share of the issuer's current net assets, or the cash equivalent thereof." Thus the shares in such a company are, by statutory definition, securities for which the holder upon demand is entitled to receive "approximately his proportionate share of the issuer's current net assets, or the cash equivalent thereof."

Virtually all open-end investment companies offer their shares for public sale through underwriters. In the typical situation the national underwriter resells the shares to local dealers, who in turn sell them to investors. The price at which the company sells to the underwriter is the current net asset value of the shares; the underwriter thereupon sells to the dealer at net asset value plus a small sales charge; and the dealer resells to the investor at the latter amount plus a further charge, generally from 5% to 7%, necessary to meet the expenses of operation, commissions of salesmen, and a profit, if any.

The offering of shares for sale through public distribution at a price above net asset value is not an indication that the shares have a value greater than net asset value. The addition of a sales charge is merely a reflection of the cost and expense to the underwriter and dealers of maintaining the public distribution system — the expense of offices, clerical staffs, salesmen, telephone and telegraph, printing, advertising, etc. — together with a potential

profit for those who spend their time and risk their capital in the endeavor. The investment company itself does not incur this expense or earn the sales charge; it derives neither profit nor loss from the public distribution activity, which is solely for the account of the underwriter and the dealers.

In every case the amount which is paid in to the investment company itself, and which is available in its hands for investment in a portfolio of securities, is limited to an amount equal to the net asset value alone. And this is the amount available to the investor upon presentation of his shares for redemption.

Quotations as to the prices of open-end investment company shares are set forth daily in the financial sections of the newspapers. Most companies calculate net asset value twice daily, once at midday and again at the close of the New York Stock Exchange. The prices quoted in the newspapers represent the closing prices for the day. Two prices are set forth for each company, one called for convenience the "bid" and the other the "asked". These terms originated in respect of *other* types of securities on the stock exchanges and on the over-the-counter markets where prices are subject to negotiation and bargaining. However, these terms, when applied to "mutuals", are merely used for convenience and do not reflect any negotiation or bargaining. As used by newspapers and in popular parlance, the term "asked" means the maximum public offering price in accordance with the company's prospectus, (*i.e.*, net asset value per share plus the maximum sales charge per share); and the term "bid" means the net asset value, at which the company stands ready to redeem its shares.

The essential features of open-end investment companies are (a) that their assets consist of marketable securities with publicly known values, and (b) that their shareholders

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have an interest in the company which entitles them upon demand to a proportionate part of its net assets or the cash equivalent thereof.

The value of each asset owned by the company is a known factor, because each asset is separately valued daily by accepted standards. The potentiality of the company for realizing income, as well as its potentiality for capital appreciation, is fully reflected in the sum total of the value of its assets, for each of its assets reflects those potentialities as they are judged in the market place by the current price at which they sell. There are no added values in a portfolio of securities which enlarge their value beyond the sum of the values of the individual securities.

Certainly in the valuation of the estate of a decedent who dies owning a variety of different securities, it has never been thought that his estate has an added value above and beyond the sum total of the values separately determined for each individual security. Similarly, there is no reason to attribute to a decedent's estate, which owns an interest in a joint securities account, a value beyond its pro rata share of the sum total of the values of the individual securities held in the account. The valuation rule should be no different for an interest in an investment company in which each shareholder has the right upon demand to withdraw his proportion of the net assets or their current value. Otherwise the sum total of the shareholders' pro rata interests in such a fluctuating fund would exceed the value of the fund as a whole; and federal taxes would be collected from the shareholder group as a whole on a basis which is mathematically incorrect.

The basic concept of open-end investment companies, with their capital structures constantly fluid as shareholders enter and leave the fold daily, is that shares are to be issued and redeemed by the company at net asset

value. This is essential for the protection of existing shareholders in order to prevent dilution of the value of their interests. Redemptions are not permitted at a price above net asset value because to do so would dilute the value of the interests of the remaining shareholders. Thus the practice in respect of redemptions is not merely evidence of the value of the pro rata interest of the withdrawing shareholder, but it reflects the value of the pro rata interests of the remaining shareholders as well. It demonstrates that the value of the right to remain in the company as a shareholder is the same as the value of the right to withdraw; the value of either or both rights is the net asset value. The fundamental method of open-end operation is premised upon the theory, therefore, that the value of each outstanding share is its net asset value.

The above principle is entirely consistent with time-honored valuation methods for federal tax and other purposes. Indeed, the opposite notion embodied in the challenged Regulation is contrary to such history. As previously stated, the sales charge, comprising part of the "public offering price" — separately itemized as required by the Securities and Exchange Commission — is merely a cost of acquisition by the investor. It adds nothing to the value of the shares, which is always the net asset value per share. It is comparable to purchase-commissions paid to acquire securities listed on the New York Stock Exchange. Such costs of acquisition are not taken into account in determining values for federal tax purposes. For example, the Estate Tax Regulations provide, as they have for many years, that for stocks traded on a stock exchange, "the mean between the highest and lowest quoted selling prices on the valuation date is the fair market value per share." (Section 20.2031-2[b]) The commission necessarily paid to a broker to make the purchase, and the stock exchange fee

and the stock transfer fee, are all a part of the acquisition cost — and would be included in "replacement cost" if that were the proper standard — but under this long-established rule they are not included in determining value for federal estate-tax purposes. This is obviously a correct principle, for such acquisition costs add nothing to the basic value of the stock. Similarly, the costs of selling the stock are not taken into account, since — although they affect the net realizable amount — they do not detract from the basic value of the stock.

To employ a different standard for valuing the shares of open-end investment companies is to employ different valuation techniques to interests in securities according to the form of transactions although their substance is identical; and this is arbitrary because inconsistent, illogical, and discriminatory.

The fact that the excess of the offering price over net asset value represents only an acquisition cost to the shareholder, adding nothing to the marketability of a share, and forming no part of its value, is clearly brought out in the typical prospectus furnished to each investor. For example, the outside front cover page of the Massachusetts Investors Trust prospectus (current on the deaths of decedents both in the New York case and in the case at bar) states:

> "The price to the public for shares offered by this prospectus varies with the fluctuations in the market value of securities owned by the trust. It is determined twice daily and is *net asset value plus a sales charge* equal to 8.5% (maximum) of the offering price, scaled down to 2-½% (minimum) depending upon size of purchase as more fully described on page 6." [Italics supplied.]

Similarly the prospectus of The Geo. Putnam Fund of Boston states on its cover page as follows:

> "The price to the public of the shares offered by this Prospectus varies with the fluctuations in the market

value of the securities owned by the Fund. The offering price is determined twice daily and is normally the net asset value per share plus a sales charge of 8-½% of the offering price, with reductions for sales in excess of $10,000, as more fully described under the caption 'Selling Price of Shares' at page 3 herein."

Thus the investor is fully informed that the offering price is not deemed a measure of the value of the shares, but is a figure compounded of (a) the true value, and (b) an additional amount spelled out as a sales commission, distribution charge, or sales charge. By the rules of the Securities and Exchange Commission it must be so spelled out in every prospectus.

Still another indication of the nature of the public offering price, in relation to the true net asset value, lies in consideration of those companies for whose shares no sales charge is imposed. The shares of a number of investment companies (*e.g.*, Scudder, Stevens & Clark Fund; Loomis-Sayles Fund; Stein, Roe & Farnham Fund) may be purchased at a public offering price precisely equal to net asset value. This is so because the underwriters for these companies maintain no dealer organization or staff of sales representatives; investors are not personally solicited but must take the initiative and apply directly to the underwriter. There is thus comparatively little, or no, sales expense or effort involved for which a sales charge would be appropriate. Yet the value of a shareholder's interest in such a company is no less than, or more than, the value of an interest in a company for whose shares a sales charge is imposed, assuming, of course, that the portfolios of the two companies were identical. It is wrong in principle and arbitrary in practice to value the shares in the two companies on different bases simply because a sales charge or commission must be paid to a third party in acquiring shares in one and not the other company. Such a rule

clearly conflicts with the sound and long-established principle that neither acquisition costs nor sales expenses are to be considered in the valuation of securities.

Moreover, the sum realizable by any legatee under a decedent's will would not be the "public offering price", but only the redemption value of the shares transferred by death. Hence to value a security, as here, at a figure which no executor, distributee, or legatee could realize on its liquidation is unrealistic and arbitrary, and results in a confiscatory tax. The validity of the position of the petitioner is strikingly portrayed in a situation where some purchaser of a "mutual" decided immediately thereafter to dispose of it. He could get back only the redemption price, although he had just paid the "public offering price." In other words, at all times the true and fair "value" of the security, as intended by the Internal Revenue Code, is the net asset or redemption value.

Finally, we refer again to Section 20.2031-1 (b) of the Estate Tax Regulations defining "fair market value" as generally meaning "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." This definition obviously is intended to apply to the ordinary market place where bargaining and negotiation ultimately result in an agreement which fixes the "value." But the market for mutual fund shares is a unique type of market. The latter is not a market place where buyer and seller meet and battle it out. If the owner of mutual shares wishes to sell them, the *only* buyer which the *willing seller* may find is the investment company itself. Being the *only* buyer, the investment company becomes a *willing* buyer only and invariably at the *net asset value.* Therefore, to consider anything over and above that value for estate-tax purposes is

not only unrealistic but arbitrary, and to exact an estate tax on any other basis than such value deprives the taxpayer of his property without due process of law in violation of the Fifth Amendment to the Constitution of the United States.

CONCLUSION

A Writ of Certiorari should be granted.

Respectfully submitted,

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